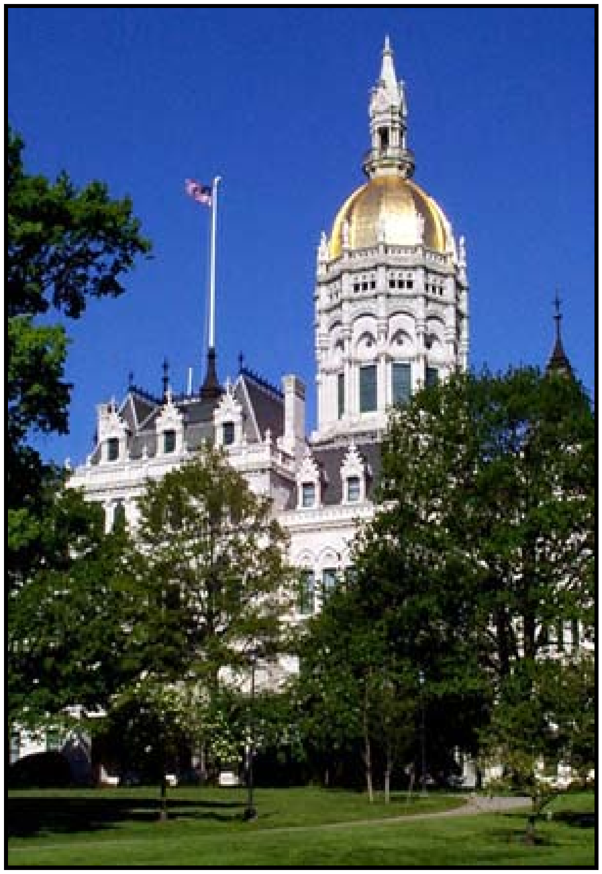
STATE OF CONNECTICUT



AUDITORS' REPORT
STATE TREASURER
STATE FINANCIAL OPERATIONS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

AUDITORS OF PUBLIC ACCOUNTS
KEVIN P. JOHNSTON ❖ ROBERT G. JAEKLE

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December 8, 2010

AUDITORS' REPORT
STATE TREASURER
STATE FINANCIAL OPERATIONS
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

We have made an examination of the financial records of the Treasurer of the State of Connecticut as they pertain to State financial operations for the fiscal year ended June 30, 2009. Throughout this report, we will refer to various financial statements and schedules contained in the Annual Report of the Treasurer, State of Connecticut, including its statutory appendix (Annual Report) for the fiscal year ended June 30, 2009.

This report on the above examination consists of the following Comments, Recommendations and Certification.

A separate report will be issued covering the internal operations of the State Treasury.

COMMENTS

FOREWORD:

The State Treasurer operates primarily under the provisions of Article Fourth of the State Constitution and Title 3, Chapter 32 of the General Statutes. Major duties include responsibilities for the receipt and investment of State moneys, disbursements and, when authorized, issuances of State obligations (borrowing).

In addition to the Executive Office of the Treasurer, the Treasury is organized into several divisions. This report includes our review of the Pension Funds Management Division, the Cash Management Division, the Debt Management Division, the Second Injury Fund and administrative requirements for the Connecticut Higher Education Trust. Comments on some of the major functions of these Divisions are presented in various sections of this report.

Officers and Officials:

The officers and officials of the Treasury Department as of June 30, 2009, were as follows:

State Treasurer: *
Denise L. Nappier

Deputy Treasurer:
Howard G. Rifkin

Assistant Deputy Treasurer:
Linda Hershman

Assistant Deputy Treasurer, Second Injury Fund and Unclaimed Property:
Maria M. Greenslade

Chief Investment Officer:
M. Timothy Corbett

Assistant Treasurer, Cash Management:
Lawrence A. Wilson

Assistant Treasurer, Debt Management:
Sarah K. Sanders

Assistant Treasurer, Policy:
Meredith A. Miller

* As used in ensuing comments of this report, the term "Treasurer" refers to the State Treasurer.

Investment Advisory Council:

The Investment Advisory Council (referred to as "IAC" or "Council" in this report) operates under the provisions of various statutes, primarily Section 3-13b. The Council's statutory responsibilities include the following:

- Review Trust Fund investments by the State Treasurer (Section 3-13b, subsection (c) (2)).

- Review the Investment Policy Statement which shall set forth the standards governing investment of trust funds by the State Treasurer. Any revisions to the Investment Policy Statement shall be made in consultation with and with the approval of the Investment Advisory Council. (Section 3-13b, subsection (c) (1)).

- Give its advice and consent to the appointment of a Chief Investment Officer for the retirement, pension and trust funds (Section 3-13a, subsection (a)).

- Make a complete examination of the security investments of the State and determine as of June 30, the value of such investments in the custody of the Treasurer and report thereon to the Governor (Section 3-13b, subsection (c) (2)).

Further, the Governor may direct the Treasurer to change any investment made by the Treasurer when, in the judgment of the Council, such action is in the best interest of the State. The Council is within the State Treasurer's Office for administrative purposes only and the Treasurer's Office continues to maintain the minutes, provide office space for meetings and other support services. The Council's expenses are paid by the Treasurer's Office from the investment earnings of the retirement and trust funds.

Council Members:

Pursuant to Section 3-13b of the General Statutes, the Investment Advisory Council, as of June 30, 2009, should consist of 12 members. The State Treasurer is an ex-officio member that also serves as Secretary of the Council. Members of the Investment Advisory Council as of June 30, 2009, were as follows:

Ex-officio members:
Denise L. Nappier - State Treasurer and Secretary of the Investment Advisory Council
Robert L. Genuario - Secretary, Office of Policy and Management

Joseph D. Roxe, Chairman
David Himmelreich
David Roth
Sharon M. Palmer
Michael Freeman
William Murray
Carol M. Thomas
Peter Thor
Thomas Barnes
Stanley Morten

James Larkin served during the audited period as Chairman until he informed the Council of his resignation on March 11, 2009.

RÉSUMÉ OF OPERATIONS:

Cash Management Division:

The Cash Management Division is responsible for the coordination of core banking services for all State agencies, receipt and disbursement tracking and reporting, bank account reconciliation, check administration, cash forecasting, cash control, outreach to State agencies, and the administration and investment of the Short-Term Investment Fund (STIF) and the Medium-Term Investment Fund known as the Short-Term Plus Investment Fund.

Cash management is defined as "the proper collection, disbursement and control of cash resources." Through four units, the Cash Management Division works to (a) speed and secure deposits of State revenues, (b) control disbursement of State funds in conjunction with the Comptroller's Office and other agencies, (c) minimize banking costs, (d) maintain accurate and timely records, and (e) productively use and invest available funds.

Deposits made to local depository accounts are regularly transferred electronically to concentration accounts for disbursement and investment purposes. Section 3-27e of the General Statutes allows the Treasury the option of paying for fees directly. During the audited period, fees for bank-provided depository, disbursement and cash management services for all State agencies were managed through a combination of direct payment and compensating balance arrangements whereby banks provide credits to pay bank fees in exchange for balances left on account with the bank by the Treasury. The direct payment option allows the Treasury to invest the cash balances in the State's Short-Term Investment Fund (STIF), which returns greater interest than that earned under compensating balance arrangements. The direct payments of bank fees are made using the interest earned on the cash balances invested in STIF. During the 2008-2009 fiscal year, the Treasury incurred $4,554,051 of bank service fees, of which $159,898 was covered by compensating balance arrangements. The Division continues to implement procedures to accelerate the collection of State receipts through the use of lock-boxes, electronic transfers and increased use of concentration account deposit tracking services.

The Cash Management Division also approves and tracks all banking relationships and bank service charges for all State agencies. When necessary, the Treasury will coordinate cash management service enhancements for individual agencies and will assist in the development and review of Requests for Proposals for more complicated cash management banking needs. The Division meets regularly with State agencies and recommends improvements in the agencies' banking relationships.

Schedules on pages S-46 through S-51 and pages O-13 to O-15 of the Annual Report deal with the Civil List Funds, which are the responsibility of the Cash Management Division.

Short-Term Investment Fund (STIF):

STIF was established and is operated under Sections 3-27a through 3-27i of the General Statutes. It provides State agencies, funds, political subdivisions and others with a mechanism for investing at a daily-earned rate with interest from day of deposit to day of withdrawal. STIF also provides participants with daily access to their account balances. Investments are mainly in money market instruments. Money market instruments are short-term debt and monetary instruments that mature in less than one year and are usually very liquid. The administrative functions and the actual investing of cash are the responsibility of the Cash Management Division. STIF maintained its AAAm rating by Standard and Poor's throughout the audited period.

The Treasurer's Office holds an annual meeting for STIF shareholders, where information such as fiscal year performance of STIF, investment strategies and administrative enhancements are discussed. The latest meeting was held March 26, 2010.

As of June 30, 2009, STIF had total net assets of $4,548,524,991. Participant distributions paid and payable during the 2008-2009 fiscal year were $69,698,998 and STIF's expenses were $1,262,329. According to the Annual Report, STIF reported an annual total return of 1.49 percent, exceeding its main benchmark, the MFR (First Tier Institutions-Only Money Fund Report) index, by .19 percent.

Statements and notes on pages F-34 through F-43 of the Annual Report deal with the Short Term Investment Fund. Also, STIF has an independent review of its Schedules of Rates of Return. This information is included on pages F-44 through F-48 of the Annual Report.

Medium-Term Investment Fund:

The 1997 Regular Session of the General Assembly passed Public Act 97-212, Section 3, codified in Section 3-28a of the General Statutes, creating a medium-term investment fund to be administered by the State Treasurer. During the 2007-2008 fiscal year, the Treasurer’s Office established client accounts for the Medium-Term Investment Fund. The Medium-Term Investment Fund includes both the Extended Investment Portfolio and the Short-Term Plus Investment Fund programs. The Extended Investment Portfolio had net assets of $250,258,784 as of June 30, 2009.

As of June 30, 2009, the Short-Term Plus Investment Fund had net assets of $88,886,784. Participant distributions paid and payable during the 2008-2009 fiscal year were $6,833,302 and the Short-Term Plus Investment Fund’s expenses were $76,204.

Statements and notes on pages F-49 through F-55 of the Annual Report deal with the Short-Term Plus Investment Fund.

Community Banking Initiative:

Pursuant to Section 3-24k of the General Statutes, the Treasurer may invest up to $100,000,000 from available State operating cash in certificates of deposit issued by community banks and community credit unions. Investments in such certificates of deposit at amortized cost amounted to $42,000,000 as of June 30, 2009.

Pension Funds Management Division:

In general, the Pension Funds Management Division (PFMD) operates under the provisions contained primarily in Part I, Chapter 32, of the General Statutes, particularly Sections 3-13a, 3-13b, 3-13d, 3-31a and 3-31b. The Division's responsibilities include the development, execution and management of investment programs of the pension and trust funds. The Division is also charged with the responsibility of making sure that pension and trust fund investments are made in compliance with State statutes and guidelines. This includes administering State law regarding corporations doing business in Northern Ireland or Iran. In addition, Public Act 06-51, effective May 8, 2007, calls for the State Treasurer to review and determine to what extent the investment holdings of the State are invested in companies doing business in Sudan and consider divestment of such holdings.

The Pension Funds Management Division is responsible for managing the assets of six pension funds and eight trust funds having total net assets of $20,382,000,000, as of June 30, 2009. The Division invests the assets of these funds in accordance with an investment program through the purchase of ownership interests in a Combined Investment Fund. Each asset class within the Fund holds investments of the Combined Investment Fund. As of June 30, 2009, the Combined Investment Fund (CIF) consisted of the Mutual Equity (MEF), Developed Market International Stock (DMISF), Emerging Market International Stock (EMISF), Core Fixed Income (CFIF), Inflation Linked Bond (ILBF), Emerging Market Debt (EMDF), High Yield Debt (HYDF), Real Estate (REF), Private Investment (PIF), Commercial Mortgage (CMF), and the Liquidity (LF) Funds. Record keeping and custody of most assets is provided by a master custodian (State Street Bank). As of June 30, 2009, the Division employed 148 external advisors to manage and invest the assets of the Combined Investment Fund.

The cost of operating the Treasury's Pension Funds Management Division, including the cost of personnel and professional investment advisors retained, is charged against the investment income of the Combined Investment Fund. Transfers are made from the investment funds to a special General Fund account from which Pension Funds Management Division operating expenses (salaries, advisor and management fees, supplies, etc.) are paid. Administrative expenses of the Combined Investment Funds, excluding external advisor expenses, were approximately $5,900,000 for the 2008-2009 fiscal year and $5,800,000 for the 2007-2008 fiscal year.

During the fiscal years ended June 30, 2009 and 2008, external advisors managed all of the CIF portfolios. The number of external advisors and advisor expenses by fund, as reported in the Combined Investment Funds financial statements and notes included in the State Treasurer's Annual Report, for services rendered during the 2008-2009 and 2007-2008 fiscal years are summarized below:

CIF	# of Advisors- June 30, 2009	Expenses 2008-2009	# of Advisors- June 30, 2008	Expenses 2007-2008
MFIF	0	$ 0	0	$ 3,381,768
CFIF	6	4,595,441	6	3,995,812
ILBF	2	944,154	2	359,428
EMDF	5	3,241,988	4	1,445,788
HYDF	4	2,321,899	4	1,629,335
MEF	10	7,729,408	7	21,876,645
ISF	0	0	0	10,526,016
DMISF	14	18,200,409	12	13,227,084
EMISF	2	6,970,008	2	5,610,307
LF	4	571,942	1	373,544
CMF	1	73,500	1	73,500
PIF	66	36,390,493	62	39,588,806
REF	34	13,395,391	23	13,013,373
Total	**148**	**$94,434,633**	**124**	**$ 115,101,406**

The above consists of the Mutual Fixed Income (MFIF), Core Fixed Income (CFIF), Inflation Linked Bond (ILBF), Emerging Market Debt (EMDF), High Yield Debt (HYDF), Mutual Equity (MEF), International Stock (ISF), Developed Market International Stock (DMISF), Emerging Market International Stock (EMISF), Liquidity (LF), Commercial Mortgage (CMF), Private Investment (PIF), and the Real Estate (REF) Funds.

During the 2007-2008 fiscal year, the International Stock Fund and the Mutual Fixed Income Fund were closed and their portfolio assets were transferred into newly created asset portfolio funds. The Investment Policy Statement was amended to include asset allocation and investment policies for these new funds. The International Stock portfolio was reallocated to the Developed Market International Stock Fund and the Emerging Market International Stock Fund. The Mutual Fixed Income portfolio was reallocated to the Core Fixed Income Fund, the Inflation Linked Bond Fund, the Emerging Market Debt Fund and the High Yield Debt Fund.

Asset Allocation Policy:

The two largest retirement plan portfolios invested by the State Treasurer are the Teachers Retirement Fund (TRF), and the State Employees' Retirement Fund (SERF) which together represent approximately 92 percent of the total assets under management. The asset allocation policy for these two retirement plans is presented below. This policy was implemented during the period under review.

	As of June 30, 2009			
	TRF		SERF	
Investment Class	**Target Upper Range**	**Actual Holdings**	**Target Upper Range**	**Actual Holdings**
U.S. Equity				
Mutual Equity Fund	35%	27.7%	35%	28.4%
International Equity				
Developed Markets International Stock	27%	22.3%	27%	22.0%
Emerging Markets International Stock	12%	5.7%	12%	5.7%
Fixed Income				
Liquidity Investment	10%	5.3%	7%	3.8%
Core Fixed Income	20%	14.5%	20%	15.1%
Inflation Linked Bond	8%	3.6%	8%	4.0%
Emerging Markets Debt	5%	5.5%	5%	5.6%
High Yield Bond	3%	3.6%	3%	3.6%
Real Estate and Alternative				
Private Investment	14%	8.0%	14%	8.0%
Real Estate	7%	3.8%	7%	3.8%
Hedge Funds	8%	0	8%	0

Asset allocations are reviewed monthly to determine whether a rebalancing of investments is necessary to maintain the desired allocation levels. During the 2007-2008 fiscal year, substantial changes were made to the asset allocation policy to reflect a restructuring of some asset classes and changes in investment strategy. A new Hedge Funds asset class was also added during the audited period although no investment commitments had been made to this class of assets.

During the fiscal year ended June 30, 2009, the Combined Investment Funds realized a net total return of (17.32) percent. During the previous fiscal year ended June 30, 2008, the Combined Investment Funds realized an annual total return of (4.71) percent.

A summary of the percentage returns of the Combined Investment Funds and the retirement and trust funds that are invested in the Combined Investment Funds, as reported in the State Treasurer's Annual Report, for the fiscal years ended June 30, 2009 and 2008 are presented below.

Combined Investment Funds:		**Percentage Return** 2008-2009	2007-2008
Net Total Combined Investment Funds		(17.32) %	(4.71) %
Mutual Equity	(MEF)	(28.36) %	(12.99) %
Developed Market International Stock	(DMISF)	(27.98) %	(14.60) %
Emerging Market International Stock	(EMISF)	(30.90) %	0.19 %
Real Estate	(REF)	(28.66) %	6.04 %
Core Fixed Income	(CFIF)	2.84 %	5.65 %
Emerging Market Debt	(EMDF)	(3.62) %	5.59 %
High Yield Debt	(HYDF)	(4.59) %	(1.88) %
Inflation Linked Bond	(ILBF)	(0.20) %	16.81 %
Commercial Mortgage	(CMF)	(3.14) %	12.05 %
Private Investment	(PIF)	(16.36) %	13.66 %
Liquidity	(LF)	1.54 %	4.59 %
Retirement and Trust Funds:			
Net Total Return Retirement and Trust Funds		(17.32) %	(4.71) %
Teachers' Retirement Fund (TRF)		(17.14) %	(4.77) %
State Employees' Retirement Fund (SERF)		(18.25) %	(4.83) %
Municipal Employees' Retirement Fund (MERF)		(14.90) %	(4.11) %
Probate Court Retirement Fund (Probate)		(15.11) %	(4.16) %
Judges' Retirement Fund (Judges')		(14.82) %	(4.11) %
State's Attorneys' Retirement Fund (St. Atty.)		(6.82) %	0.37 %
Trust Funds		(3.46) %	2.08 %

Investment performance for individual retirement funds varies based on the mixture of asset class types held by each. The investment performance for Trust Funds is a composite of returns earned by eight trust funds that participate in the Treasurer's Combined Investment Funds. During the fiscal year, Trust Funds included the School and Agricultural College Funds, The Soldiers' Sailors' and Marines' Fund, the Police and Fireman's Survivors' Benefit Fund, Endowment for the Arts, Hopemead Fund, Ida Eaton Cotton Fund and the Andrew Clark Fund.

A more thorough discussion of the Combined Investment Funds, including performance during the 2008-2009 fiscal year, can be found on pages 14 through 74 of the Annual Report.

Statements and notes on pages F-14 through F-31 of the Annual Report deal with the Combined Investment Funds. Supplemental information on the pension plans and trust funds is included on pages S-1 through S-41 of the Annual Report.

Investment Mix:

A summary of the Retirement Funds' investment activity in the Combined Investment Fund is presented below. The amounts below are presented in millions of dollars.

Participant Funds	6/30/08 Market Values	Share Transactions Purch	Share Transactions Redemp	Share Transactions Net	Gain on Redemp	Change in Mkt. Value	6/30/09 Mkt. Values	Percent Holdings	Inv. Income
	$	$	$	$	$	$	$		$
TRF	14,542	3,407	3,618	(211)	24	(2,958)	11,397	53 %	394
SERF	9,330	1,508	1,556	(48)	12	(1,973)	7,321	39 %	252
MERF	1,627	270	260	10	1	(293)	1,345	7 %	49
Probate	81	15	16	(1)	0	(14)	66	0 %	2
Judges'	177	25	23	2	0	(31)	148	1 %	5
St. Atty.	1	0	0	0	0	0	1	0 %	0
Trust Funds	114	9	9	0	0	(10)	104	0 %	5
Transfers		1,365	1,365						
Totals	**$25,872**	**$6,599**	**$6,847**	**$(248)**	**$37**	**$(5,279)**	**$20,382**	**100%**	**$707**

A summary of the Combined Investment Fund's activity is presented below. The amounts below are presented in millions of dollars.

Combined Investment Funds	6/30/08 Net Assets	Participant Fund Activity Purch	Redemp	Income Distrib	Net Contrib	Invest Return	6/30/09 Net Assets
LF	$2,161	$ 4,262	$ 4,251	$ 33	$ (22)	$ 32	$2,171
MEF	8,000	0	0	143	(143)	(2,267)	5,590
DMISF	5,108	746	0	109	637	(1,329)	4,416
EMISF	1,304	200	0	17	183	(340)	1,147
CFIF	4,537	0	1,236	207	(1,443)	66	3,160
ILBF	1,172	0	300	26	(326)	(9)	837
EMDF	1,047	177	5	45	127	(42)	1,132
HYDF	759	58	0	58	0	(26)	733
REF	1,003	86	0	20	66	(299)	770
CMF	7	0	1	1	(2)	0	5
PIF	1,795	201	0	58	143	(311)	1,627
Elim. Entry*	(1,021)	868	1,053	(8)	(177)	(8)	(1,206)
Totals	**$25,872**	**$6,598**	**$6,846**	**$709**	**$(957)**	**$(4,533)**	**$20,382**

*The "elimination entry" removes the Liquidity Fund investments of each of the other asset classes so that it will not be counted twice in the totals.

The investment activity information is presented in detail in the Treasurer's Annual Report, pages S-2 through S-17.

Investment Advisory Council Expenditures:

State Treasurer expenditures, for the IAC for the fiscal years ended June 30, 2008 and June 30, 2009, were $17,711 and $16,249, respectively. Amounts were for meeting costs, travel, postage and other expenses.

Debt Management Division:

The Treasurer has the responsibilities to manage the debt of the State and to administer the financial needs of the bonding programs enacted by the State Legislature and authorized by the Bond Commission. These responsibilities are carried out through the Debt Management Division.

A summary of bonds issued, paid, or refunded in the 2008-2009 fiscal year and the obligations outstanding, as of June 30, 2009, is presented in the schedule entitled Changes in Debt Outstanding shown on page S-42 of the Annual Report, while additional information is contained in the Annual Report pages S-43 and O-1 through O-12. A brief summary follows:

Bonds Outstanding June 30, 2008	$16,437,563,328
Add - Issuances	3,266,320,000
Deduct - Payments at maturity	1,238,244,555
- Bonds refunded or defeased	579,600,000
Bonds Outstanding June 30, 2009	**$17,886,038,773**
Interest paid	**$905,856,976**

Bonds and Notes issued in 2008-2009 by type are shown below:

General Obligation - Tax Supported	$1,209,215,000
General Obligation – Bond Anticipation Notes	581,245,000
Special Tax Obligation – Transportation Fund	812,725,000
Clean Water Fund	440,195,000
UCONN 2000	144,855,000
Connecticut Health and Educational Facilities Authority – Child Care Facilities Program	16,875,000
Capital City Economic Development Authority Bonds	22,500,000
Connecticut Housing Finance Authority - Special Needs Housing Bonds	38,710,000
Total Bonds Issued, 2008-2009	**$3,266,320,000**

True interest cost rates for new bonds issued during the 2008-2009 fiscal year ranged from 0.62 percent for bond anticipation notes with a one year average life to 6.33 percent for taxable bonds with an average life of twenty years. Bonds issued during the 2008-2009 fiscal year were comprised of new money issues amounting to $2,634,820,000 and refunding issues amounting to $631,500,000.

In addition to the interest paid totaling $905,856,976, during the 2008-2009 fiscal year, the

Treasury also made arbitrage rebate payments to the Federal government totaling $7,928,188. Such rebates represent the excess earnings of nontaxable bond proceeds that were invested in STIF prior to project disbursement.

In accordance with Section 3-20 of the General Statutes, whenever the State Bond Commission has adopted a resolution authorizing bonds, the Treasurer may issue temporary notes in anticipation of the sale of bonds. Such bond anticipation notes amounting to $581,245,000 were issued during the audited period. Bond anticipation notes amounting to $353,085,000 matured in April 2010. The remaining $228,160,000 of bond anticipation notes will mature in June 2011.

Bonds outstanding at June 30, 2009 include $13,790,000 of Certificates of Participation for the Middletown Courthouse and $16,520,000 of Certificates of Participation for the Connecticut Juvenile Training School Energy Center project. These Certificates are not bonded debt of the State; however, the State is obligated to pay a base rent under leases for these facilities, subject to the annual appropriation of funds or the availability of other funds therefor. The base rent is appropriated as debt service. The Certificates of Participation are included on the Treasurer's Debt Management System for control purposes.

Further, the Connecticut Development Authority issued $9,275,000 of its lease revenue bonds for the New Britain Government Center in the 1994-1995 fiscal year, of which $3,535,000 is outstanding at June 30, 2009. The State is obligated to pay the base rent subject to the annual appropriation of funds. These payments are budgeted in the Treasurer's debt service budget as lease payments and are included in the above summary.

Section 32-607 of the General Statutes authorizes the board of directors of the Capital City Economic Development Authority to issue bonds and notes in such principal amounts necessary to carry out the Authority’s purposes. Pursuant to Section 32-608 of the General Statutes, the State has entered into a contract to pay assistance to the Authority in an amount equal to the annual debt service of the outstanding amount of bonds issued by the Authority. Bonds covered by this State assistance contract amounting to $22,500,000 were issued during the audited period. As of June 30, 2009, outstanding bonds subject to this State assistance contract totaled $105,115,000.

The Connecticut Child Care Facilities Program is established pursuant to Section 10a-194c of the General Statutes to finance low interest rate loans for child care and child development centers. This statute also authorizes the Connecticut Health and Educational Facilities Authority to issue bonds in order to fund the loans. Further, the State has agreed through a Memorandum of Understanding between the Department of Social Services and the Authority to provide the debt service for such Child Care Facilities Bonds. As of June 30, 2009, Child Care Facilities Bonds outstanding totaled $69,600,000.

In accordance with Section 17a-485e of the General Statutes, the State Treasurer and the Office of Policy and Management entered into a contract to provide State assistance to the Connecticut Housing Finance Authority (CHFA) for the payment of debt service on Authority bonds issued for the purpose of providing mortgage loans under the Supportive Housing Initiative program. The statute allows State assistance for such bonds in an aggregate principal amount not to exceed $70,000,000. As of June 30, 2009, CHFA Special Needs Housing Bonds outstanding totaled

$63,755,000.

Tax Exempt Proceeds Fund (TEPF):

The Tax Exempt Proceeds Fund, codified as Sections 3-24a through 3-24h of the General Statutes, serves as a vehicle to allow the State Treasurer to comply with arbitrage requirements of the Tax Reform Act of 1986 with regard to the proceeds of nontaxable bond issues passed through to municipalities, nonprofit organizations and others as grants and loans. The arbitrage provision of the Tax Reform Act requires that any earnings on bond proceeds in excess of the interest rate on the bonds be rebated to the Federal government unless those proceeds are invested in other tax-exempt securities. Under the Tax Reform Act, such pass-throughs are not considered expended when the State advances the funds to the recipient. Accordingly, without TEPF the State would have to track the investment of proceeds of some bond issues until they are ultimately disbursed to contractors and vendors. Proceeds deposited into the fund can leave it only for a payment to a contractor, a vendor, or as a reimbursement.

The TEPF was incorporated as a regulated investment company and is managed by a firm retained by the State Treasurer. In addition to State agencies, TEPF may be used by authorities, municipalities and others. The TEPF was audited by a firm of independent public accountants for the 2008-2009 fiscal year.

According to the Annual Report of the TEPF, net assets of the fund totalled $132,177,620 at June 30, 2009, and the fund’s total return was 1.10 percent for the 2008-2009 fiscal year. Participants in the fund at June 30, 2009, included civil list funds and recipients of State agency grant and loan programs as well as others.

At June 30, 2009, a total of $18,803,803 of State funds was invested in the TEPF as shown below:

Fund Classification	Amounts	Annual Report Page No.
Special Revenue	$11,709,938	O-13
Capital Projects	12,080	O-14
Enterprise	7,081,785	O-14
Total	**$18,803,803**	O-14

Second Injury Fund:

The operations of this fund are provided for by various statutes of the Workers' Compensation Act, Chapter 568, of the General Statutes (notably Sections 31-310 and 31-349 through 31-355b). This Act provides protection for employees suffering occupational injuries or diseases and establishes criteria determining whether benefits due employees are to be paid by the employers (or their insurance carrier) or out of the Second Injury Fund (SIF). The Treasurer is the custodian of SIF. Per Section 31-349e of the General Statutes, there is an advisory board to advise the custodian of SIF on matters concerning administration, operation, claim handling and finances of the fund.

Fund revenues consisted mainly of assessments levied against self-insured employers and companies writing workers' compensation or employers' liability insurance and totaled $36,986,395 for the 2008-2009 fiscal year.

Second Injury Fund claim payments amounted to $37,539,670 for the 2008-2009 fiscal year. A comparison of claim expenditures by category follows:

	2008-2009	2007-2008
Stipulations	$ 10,117,350	$ 9,975,232
Indemnity (lost wages)	21,269,642	21,289,614
Medical	6,964,852	6,274,824
Totals	$38,351,844	$ 37,539,670

The number of stipulated agreements to settle claims increased during the current audited period. According to the Treasurer's Annual Reports, the number of settled claims totaled 180 and 181 for the fiscal years ended June 30, 2008 and 2009, respectively.

Financial statements and notes for the SIF are presented on pages F-62 through F-68 of the Annual Report.

Workers' Compensation Commission - Administrative Expenses:

As authorized under the Workers' Compensation Act of the General Statutes, the Second Injury and Compensation Assurance Fund and the administrative expenses of the Workers' Compensation Commission (WCC), are financed by assessments against companies writing workers' compensation or employers' liability insurance and by assessments against self-insured employers.

Assessments are based on workers' compensation benefits paid by the applicable companies. Data concerning the companies writing workers' compensation insurance is furnished by the State Insurance Department. Self-insurers report directly to the State Treasury. A list of such companies is supplied by the Workers' Compensation Commission. ("Certificates of Solvency" are issued by that Commission.) By far, the greater portion of assessments is levied against insurance companies rather than self-insured employers.

Under Section 31-345 of the General Statutes, the Treasurer must assess and collect from the above insurance carriers and self-insurers amounts to reimburse State expenses incurred by the WCC in the administration of workers' compensation benefits. In accordance with Section 31-345, the WCC's chairman notified the Treasurer of the amount needed to meet the expenses of the WCC for the fiscal year. Based on the projection, less the balance in the WCC account, the Treasurer assessed insurance companies and self-insured employers during the audited period at a rate based on their preceding fiscal year’s payments for workers’ compensation benefits. Collections of these assessments are deposited into the Workers' Compensation Administration Fund.

A summary of Workers' Compensation Administration (WCA) Fund assessment receipts and total WCA Fund receipts for fiscal years 2008-2009 and 2007-2008 follows:

	2008-2009	2007-2008
Assessment collections	$22,045,237	$20,563,416
Other receipts	39,620	22,343

Total Receipts - WCA Fund	**$22,084,857**	**$20,585,759**

Connecticut Higher Education Trust:

The Connecticut Higher Education Trust (CHET) was established pursuant to Public Act 97-224, codified as Sections 3-22e through 3-22o of the General Statutes. CHET is a trust, available for participants to save and invest for higher education expenses, that is privately managed under the supervision of the Treasurer. The Trust is an instrumentality of the State; however; the assets of the Trust do not constitute property of the State and the Trust shall not be construed to be a department, institution or agency of the State. CHET is a qualified State tuition program in accordance with guidelines contained in Section 529 of the Internal Revenue Service code. While money is invested in CHET, there are no taxes (Federal or State) on the earnings. Amounts can be withdrawn to pay for tuition, room and board, or other qualified higher education expenses. There are no State taxes paid on qualified withdrawal earnings. The program began accepting applications in January 1998.

The Connecticut Higher Education Trust was audited by a firm of independent public accountants for the 2008-2009 fiscal year.

As of June 30, 2009, the CHET program had net assets of $1,049,268,106, and 86,559 participant accounts. Operating results for the 2008-2009 fiscal year taken from the Annual Report were as follows:

Net assets at June 30, 2008	$1,076,674,472
Net participant contributions	100,224,718
Net decrease from operations	(127,631,084)
Net assets at June 30, 2009	**$1,049,268,106**

Financial statements and notes for CHET are presented on pages F-68 through F-74 of the Annual Report.

Trust Funds:

In addition to investment-type trust funds of the Pension Funds Management Division (described earlier in this report) and those in CHET, the Treasurer is also responsible for the administration of certain other trust funds which fall within her statutory jurisdiction. Some of these funds are described in the ensuing section.

School and Agricultural College Funds:

The administration of these two trust funds is provided for in Sections 3-40 through 3-55 of the General Statutes. Under Article Eighth, Section 4, of the Constitution of the State of Connecticut, the School Fund is a perpetual fund whose interest is to be used in support of State assistance to public schools. Annually, fund earnings are transferred to the General Fund from which public education grants are made. Under Section 10a-115 of the General Statutes, net income of the Agricultural College Fund is transferred to the University of Connecticut.

Investments consisted of participation in the Treasurer's major asset classes. No direct individual investments were held by the two trust funds. Total fund balances, at cost, on June 30, 2009, amounted to $6,920,791 for the School Fund and $442,280 for the Agricultural College Fund. The total fund balances on June 30, 2009, at fair value, amounted to $8,274,302 for the School Fund and $532,186 for the Agricultural College Fund. Statements and notes for these two funds and other non-civil list trust funds are included on pages F-56 through F-60 of the Annual Report. Investment activity is presented on pages S-12 through S-17.

Insurance Companies Trusteed Securities:

Pursuant to Section 38a-83 of the General Statutes, securities are deposited with the Treasurer to be held in trust for policy holders of insurance companies as a prerequisite to such companies transacting business in any state requiring such protection. A listing of insurance companies and their security deposits, as of June 30, 2009, is presented starting on page O-16 of the Annual Report.

Each company depositing these securities is required, per Section 38a-11, subsection (e), to pay $250 annually to defray the cost of custodial services, which is collected by the Insurance Department.

CONDITION OF RECORDS

Our review of the financial operations of the State Treasury disclosed some areas requiring additional attention. These areas are described on the following pages.

Unreconciled Cash Account within Cash Management Division:

Criteria: The State's Core-CT accounting system has the potential to perform automated bank reconciliations which would identify all outstanding items as to date and amount. It is the responsibility of the Cash Management Division (CMD) to research and resolve unidentified variances when reconciling the bank accounts.

Condition: During our audit of the Cash Management Division, we noted the State's payroll bank account was not completely and accurately reconciled directly to the general ledger cash account in the Core-CT accounting system. This reconciliation was not conducted in a manner which resolves all variances between the bank records and the Core-CT accounting records. As of June 30, 2009, the unexplained variance in the payroll account is $597,842.

The CMD continues to rely on a manual reconciliation process to reconcile to the State's payroll accounts. Current manual procedures are not sufficient to identify and explain all variances in the payroll account. The Core-CT accounting system does not have the ability to identify cleared payroll checks. The monthly bank reconciliation report from Core-CT provides an end of the month net change in account balance by State agency but does not provide detailed information on individual bank transactions.

The Comptroller and agencies journalize recovery of payroll overpayments as adjustments in the payroll account in Core-CT. These adjustments are not cleared directly through the payroll bank account and daily downloads from the bank only reflect cash transactions that have been cleared. The Comptroller does not maintain an Account Receivable balance that would track payroll overpayments that are due to the State. An Account Receivable amount for payroll overpayments would assist in reconciling the adjustments in the payroll account.

Cause: The agencies may not have journalized the reclassification of these deposits or the Comptroller may not have processed the entries to offset the agencies' adjusted entries in the payroll account. Errors in the recording of the adjustments made to the payroll account may not be detected in a timely manner if deposit information is not coded correctly in Core-CT by the agencies.

Effect: The CMD cannot accurately and completely reconcile the payroll account ledger balance to the bank statement with the current manual procedures due to the lack of a net payroll adjustments figure with supporting details.

Recommendation: The Cash Management Division should require that agencies make recovery of State funds adjustments in the separate payroll correction account which was created by the Comptroller's Office. The CMD should work with the Comptroller's Office to enhance the reporting capabilities of Core-CT and setup an Accounts Receivable account to track overpayment recoveries which would also assist in reconciling the overpayment recoveries adjustments to the payroll account. (See Recommendation 1.)

Agency Response: "We have commenced work with the Comptroller's Office on establishing and using a new Accounts Receivable account for all payroll recoveries and will remind agencies to use the account as required by the Comptroller's Office. We understand that full implementation of that account will require Core-CT modifications by the Comptroller's Office. Until those modifications are completed, both offices will need to use interim procedures and adjustments."

Municipal Participation Account Implementation:

Criteria: The Municipal Participation Account was established pursuant to Section 16-50bb of the General Statutes to hold the application fees paid by energy companies seeking to obtain certification from the Connecticut Siting Council. Section 16-50bb of the General Statutes states that the State Treasurer shall make payments from the account to participating municipalities not later than sixty days after receipt of an application and any moneys remaining at the end of a proceeding shall be refunded to the applicant.

According to Section 3-39b of the General Statutes, any State funds invested by the Treasurer shall be for the benefit of the General Fund unless otherwise provided by statute. Section 16-50bb of the General Statutes states that the interest derived from the investment of the account shall be credited to the account.

Condition: The Treasurer has not credited interest earnings to the Municipal Participant Account since the inception of the account. As of the time of our field work, the balance in the Municipal Participation Account totaled $249,913. Since the Municipal Participation Account became effective on July 1, 2003, $300,000 had been collected representing twelve dockets, and $50,087 had been distributed to participating municipalities.

The proceedings for nine dockets have concluded, and seven have funds remaining, totaling $175,000 which should have been returned to the applicants as required by 16-50bb of the General Statutes. The first decision in which funds should have been returned occurred over four years ago.

Cause: A lack of coordination between the Connecticut Siting Council and the Treasury contributed to the failure to return unexpended funds at the conclusion of a proceeding. Interest earned by Municipal Participation Account funds was credited to the General Fund.

Effect: The interest earned by the investment of the Municipal Participant Account monies was not credited to the account as required by statute. There is decreased assurance that all eligible municipalities are being served due to the lack of procedures for program disbursements.

Recommendation: The Treasurer should credit the Municipal Participant Account with interest earnings as provided by statute and disburse funds in accordance with statutory requirements. (See Recommendation 2.)

Agency Response: "We have made the recommended actions. First, the Municipal Participant Account was enrolled in the interest credit program in September 2009 when the Siting Council made its written request, consistent with our policy that was reviewed and approved by the Auditors in 1995. The delay in awarding interest to the account did not affect any municipality because interest can only be paid when two or more municipalities request reimbursements for one proceeding in excess of a total of $25,000. That situation has not occurred to date.

Second, we have developed procedures with the Siting Council regarding the timely reimbursement of municipal expenses related to Siting Council proceedings and the refund of unexpended funds to utilities. Pursuant to those procedures, the Siting Council's $175,000 refund request was processed in November 2009. Another $25,000 refund request was processed in June 2010. Three more refunds are being processed."

Review of Second Injury Fund Payments and Collections:

Criteria: Section 31-349g-5(a)(1) of the Regulations of State Agencies states that self-insured employers shall be assessed a Second Injury Fund (Fund) surcharge at a rate determined by the State Treasurer.

Section 31-353 of the General Statutes states generally that if the Second Injury Fund and an injured employee's representative reach an agreement in regard to compensation payable, such agreement shall be submitted in writing to the Workers' Compensation Commissioner for approval.

Pursuant to Section 31-307a of the General Statutes, employers or insurance carriers may be reimbursed for the actual cost of living adjustments (COLAs) made on injured workers' payments. Reimbursements may be paid if they are accompanied by vouchers and other information that the Treasurer may require; however, no claim for payment may be made to the Second Injury Fund (Fund) more than two years after the date on which the benefits were paid.

Condition: The Treasurer established the assessment rates for self-insured employers at 6.7 and 4.7 percent for the fiscal years ended June 30, 2008 and 2009, respectively. During our review, we discovered that one self-insured employer was charged the higher assessment rate for the fiscal year ended June 30, 2009. This was not noticed until we brought it to the Fund's attention.

A claims analyst with the Fund reached an agreement with an injured worker's representative in regard to compensation payable; however, the payment does not appear accurate and the agreement was not submitted in writing to the Workers' Compensation Commissioner for approval. Although it is difficult to determine the judgment that would have been applied by the Workers' Compensation Commissioner, we estimated the injured worker may be entitled to an additional $1,478 of benefits.

The Fund paid one insurance company a COLA reimbursement that was a negotiated amount. The insurance company's requested amount had to be reduced because some of the injured worker's expenses had been paid by the Social Security Administration. Our review of the supporting documentation for this negotiated payment indicated that a portion of the negotiated settlement included restitution for dates of service that were outside the eligibility period for reimbursement. The insurance company was reimbursed $33,092 for COLA payments that were outside of the eligibility period.

Cause: The application of the assessment rate change excluded one self-insured employer and the Fund's internal controls did not prevent or detect the error.

The Fund negotiated a lump-sum settlement to avoid claims for COLA reimbursements some of which contained ineligible dates of service.

Effect: The self-insured employer was overcharged $1,549 due to the misapplication of assessment rates.

There is less assurance that benefits are negotiated and paid properly if they are not approved by the Workers' Compensation Commissioner.

The negotiated settlement of one COLA reimbursement appeared to involve dates of service that could have been contested and disallowed.

Recommendation: The Second Injury Fund should submit negotiated compensation agreements to the Workers' Compensation Commissioner for approval, ensure that self-insured employer assessment rates are applied without error and contest non-qualifying COLA reimbursement requests. (See Recommendation 3.)

Agency Response: "We concur with the auditors' recommendations.

With respect to the assessment rate change finding, the Fund issues approximately 700 invoices for Fiscal Year 2009 totaling $6.8 million for self-insured employers. During this period four invoices were issued with the misapplication of the assessment rate resulting in an overpayment, by the company, of $1,549 for the year. A credit was applied to the company's assessment for Fiscal Year 2010. The Fund examined its procedures and employees were reminded of the need to follow implemented processes.

With respect to COLA reimbursements, the Office of the Attorney General advised the Fund to honor notices of reimbursement received prior to the 2006 law change.

In the one instance noted by the APA's the Workers' Compensation Commission did not set a rate for benefits; if this occurs again the Fund will seek the approval of the Workers' Compensation Commission."

Administration of Alternative Investments:

Criteria: Statement on Auditing Standards No. 1 details certain responsibilities of Management and states that Management is responsible for adopting sound accounting policies and for establishing and maintaining internal control that will initiate, record, process and report transactions, as well as events and conditions. Management is responsible for the information included in the financial statements. According to Generally Accepted Accounting Principles, real estate investments should be valued at fair value and losses should be realized appropriately.

The Investment Policy Statement (IPS) sets forth the general principles that govern the investments of the State's retirement plans and trust funds in accordance with Section 3-13b, subsection (c), of the General Statutes. Specifically, Article X, Section D., of the IPS for real estate investments stipulates that, (a) leverage shall not exceed 60%, and that (b) redemption provisions shall be clearly defined.

A due diligence review should verify that contracts for investments are (a) signed by the Treasurer, and (b) require audited financial statements of market value, which provide critical information as to the market valuations presented for each investment.

Condition:

Accuracy of Market Values: Within the Real Estate Fund, we question the accuracy of the market values for four of 34 investments included in the financial statements as of June 30, 2009:

- Two investments appear to be overstated. When we brought this matter to the Treasury's attention, the Treasury declined to adjust its financial statements. We estimated the overstatement at between $12,489,609 to $37,489,609 or 1.3 to 3.8 percent of the total Real Estate Fund. One investment confirmed that its market value as of June 30, 2009, was $2,489,609 less than what was presented within the financial statements. Another investment's market valuation of $35,000,014 did not seem reasonable considering that (a) no audited financial statements were available to substantiate the market valuation, (b) the capital account, which represents what is owned by the limited partners, including the State Treasury, was reported at below zero, and (c) the Principal Investment Officer of the Real Estate Fund spoke of the investment in patently negative terms.

- We also question the accuracy of two other investments' valuations totaling $31,601,453, with associated costs of $32,500,000 as of June 30, 2009. These valuations were questioned for several reasons, including that the market valuations seemed inexplicably similar to the cost during a period of unprecedented market declines. Also, no audits were provided and other information was presented that indicated they had declining revenues. There was an audit of the partnership capital account, which appears to support that the investments exist; however, the Treasury is required to report its investments at market value, which was not verifiable at this time. Treasury was unaware of this situation until we brought it to their attention.

Accuracy of Realized Losses and Disclosure Amounts: We also noted that realized losses were erroneously included in unrealized losses and commitment disclosure amounts were overstated for the alternative investments.

- Realized losses for one investment within the Real Estate Fund should have been recorded properly in the amount of $15,901,057. Subsequent to our inquiry, this was corrected.

- Realized losses for eight investments within the Private Investment Fund also needed adjustments totaling $110,567,203. Subsequent to our inquiry, this was corrected.

- Disclosure amounts that detail the total investment amounts committed to the Private Investment Fund were overstated in the amount of

$124,305,402. Subsequent to our inquiry, the Treasury adjusted the amounts.

Due Diligence and Monitoring Concerns: Within the Real Estate Fund and Private Investment Funds, we had due diligence or monitoring concerns:

- Two investment contracts (noted above) that committed a total of $50,000,000 did not require audited financial statements of market values. The same contracts provided the investment advisor a power of attorney (POA) clause, to sign on behalf of the Treasurer. This investment advisor used its POA to sign the actual contracts on behalf of the Treasurer.

- There were several other audit reports that were not obtained and reviewed by the Principal Investment Officer of the Real Estate Fund in a timely manner. One investment manager, (with investments valued at $35,000,014) was authorized to forgo its audit.

- Contractual provisions for one limited partnership were extended for an additional year by the Principal Investment Officer for the Real Estate Fund without the proper authority of the State Treasurer.

- We found that late market value reset adjustments in excess of $10,000,000 were not signed-off on by Principal Investment Officers as required by the Treasury's policy for the alternative investments.

Adherence to Guidelines: We found instances when Investment Policy Statement guidelines were not adhered to within the Real Estate Fund:

- There continue to be no clearly-defined redemption provisions for the open-ended real estate investment trusts within the Real Estate Fund as required by the Investment Policy Statement.

- Certain authorized investments for the Public Private Investment Program as well as two other investment contracts appear to exceed the 60% leverage requirement set forth in the Investment Policy Statement.

Cause: The alternative asset classes were not always administered to a level of prudent care during the due diligence, execution, monitoring and reporting stages to ensure accurate financial reporting.

Effect: There is less of an assurance that the Treasury can effectively administer certain complex aspects of the alternative investments funds it is currently invested in and the hedge fund asset class it plans to invest in.

Recommendation: The State Treasury should administer its responsibility for the alternative assets with more diligence and care, improve the monitoring of advisors and its financial reporting, and be sure the guidelines are effectively applied. (See Recommendation 4.)

Agency Response: "The majority of the findings by the Auditors of Public Accounts ("APA") are the result of one $100 million investment made in 1998 by the former administration into Westport Senior Living Fund ("Westport"). The Nappier administration attempted to reduce or eliminate this contractual obligation, but was forced to be held to the terms of this contract by the Fund's General Partner ("GP"). Since that time oversight of this particular investment is held to a higher standard. The following findings are specifically associated with this investment.

- Reasonableness of market value of $35,000,014
- Investment manager allowed to forgo its audit
- Realized losses not promptly recorded

The CRPTF shares the APA concerns about the difficulties associated with monitoring this investment, including barriers to obtain information and inability of the Fund to meet its contractual obligations. At the time of the audit, CRPTF had documentation to support the market values for the underlying assets of the fund, and a legal opinion that asserted that there were no cross-collateralization or cross-default provisions that would result in a negative capital account for investors. Subsequent to the audit, CRPTF received an audited financial report that now raises the going concern of the investment and as such CRPTF will write down the entire investment balance in the current fiscal year ended June 30, 2010.

The CRPTF never authorized this fund to forgo its audit. The GP elected to perform two property level audits in preparation for sale of these final two assets rather than a partnership audit.

With regard to other findings:

Information for the market value overstated by $2,489,609 was received after fiscal year end close, deemed to be a non-material amount, and booked in accordance with normal procedures.

Two Fund valuations totaling $31,601,453 and $32,500,000, while costs and market value were similar it was based upon audited financial statements and substantial documentation on the market value of the two wholly owned subsidiaries of the Fund in question.

Authority was delegated by the Treasurer, as noted in the Limited Authorization Certificate, dated October 17, 2006, for all partnership agreements, that delegates approval of a one-year extension by the Principal Investment Officer for Real Estate.

Notwithstanding the audit finding above, the CRPTF, through its contract negotiation process, required and documented clearly defined redemptions for all open-ended account contracts. The IPS will be amended to more clearly reflect this practice for real estate.

All investment contracts do require audited financial statements by a public audit firm. The CRPTF has a tracking system in place to ensure timely receipt of audited financial statements. Each audit report was reviewed by professional staff.

The use of limited power of attorney language in investment contracts was reviewed by outside counsel and the Office of the Treasurer General Counsel; both legal parties opined that this language represents standard industry practices.

In reference to the individual real estate investment that exceeded leverage of 60%, the CRPTF was in compliance with policy. The IPS appendix states that leverage for the REF shall be measured at the aggregate Fund level, not at the individual fund investment, by comparing the principal amount of debt secured by real estate investments in the portfolio annually to the gross market value of the real estate portfolio."

Tax Filing Agent:

Criteria: The Investment Policy Statement requires that Emerging Market Stock Fund managers invest only in liquid stocks. Investors that own securities in the country of Taiwan must appoint a local tax filing agent in order to liquidate the investment and repatriate the income and capital gains accruing from their investments.

Condition: The Pension Funds Management Division authorized an investment manager to invest in foreign stocks from the country of Taiwan without appointing a local tax filing agent. As a result, the manager made significant investments in Taiwan stocks, many of which have increased in value, but is unable to sell the stocks and realize any of the gains due to the inability to repatriate the income and capital gains. As of June 30, 2009, this manager was holding Taiwan stocks with an aggregate market value of $69,160,392. During the audited period, the State was able to repatriate the principal invested of $58,673,445 but was unable to retrieve the capital gain of $10,486,947 because a local tax filing agent was not appointed.

Cause: It appears that the need for a tax agent was not considered at the time the manager was given the authorization to invest in Taiwan.

Effect: Capital gains totaling $10,486,947 were not available for distribution. The State is in effect shut off from selling stocks that normally are considered to be highly liquid. The investment manager is not able to actively manage these holdings since the proceeds from sales cannot be distributed.

Recommendation: The Treasurer's Pension Fund Management Division should appoint a local tax filing agent to expedite the repatriation of capital gains from foreign countries. (See Recommendation 5.)

Agency Response: "The CRPTF had identified the need for a tax agent when it contemplated a restructure within the emerging market equity portfolio associated with the hiring of new emerging market equity managers during the fall of 2009. The outside tax counsel for the Office of the Treasurer has been assigned the responsibility for engaging and monitoring local tax agents. Tax counsel is negotiating with a national independent accounting firm to serve as tax agent in Taiwan, at which time the CRPTF will be in a position to reclaim its capital gains. In addition, tax counsel is currently conducting a tax review of all CRPTF contracts in an effort to maximize recovery or repatriation of all taxes paid in jurisdictions where CRPTF investments are exempt from taxation."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

Our prior audit examination resulted in six recommendations. The following is a summary of those recommendations and the action taken by the State Treasury.

- The Cash Management Division should improve internal controls over cash accounts and ensure all variances between the bank and Core-CT records are explained and have been completely resolved. This recommendation has been restated to reflect current conditions and presented as Recommendation 1.

- Treasury should report irregular and unsafe handling of the State funds in a timely manner and request that Core-CT administration improve security procedures to protect the integrity of bank data. This recommendation has been resolved.

- The Treasurer's Cash Management Division should implement automated processes that would ensure that checks that have been presented for payment and cleared are reflected in the State's accounting records. The Cash Management Division is working to correct this condition so this recommendation has not been repeated.

- Treasury should verify, on a daily basis, that the total checks issued amount per the Comptroller's Office and the total checks issued amount per Core-CT are in agreement and request that Core-CT administration improve procedures to protect the integrity of bank data. This recommendation has been resolved.

- The Treasurer's Pension Fund Management Division should ensure that collateral received for security lending purposes is in compliance with the requirements of Section 3-13d of the General Statutes. This recommendation has been addressed and is not repeated.

- The Office of the State Treasurer should avoid investment arrangements that do not contain timely redemption provisions when there is a lack of a contract-end period and follow internal procedures for signing wire transaction requests. This recommendation is not repeated.

Current Audit Recommendations:

The following recommendations resulted from our current review.

1. **The Cash Management Division should require that agencies make recovery of State funds adjustments in the separate payroll correction account which was created by the Comptroller's Office. The CMD should work with the Comptroller's Office to enhance the reporting capabilities of Core-CT and setup an Accounts Receivable account to track overpayment recoveries which would also assist in reconciling the overpayment recoveries adjustments to the payroll account.**

   Comments:

   During the audited period, the State's payroll bank account was not completely and accurately reconciled directly to the general ledger cash account in the Core-CT accounting system. As of June 30, 2009, the unexplained variance in the payroll account is $597,841.94.

   Adjustments made to the payroll cash account for reasons such as recovery of payroll overpayments are not cleared directly through the payroll bank account. The accounting entries to record payroll adjustments must be made by the originating agency. Errors in the recording of the adjustments made to the payroll account may not be detected in a timely manner because the Comptroller does not maintain an Account Receivable balance that would track overpayments that are due to the State.

2. **The Treasurer should credit the Municipal Participant Account with interest earnings as provided by statute and disburse funds in accordance with statutory requirements.**

   Comments:

   The Treasurer has not credited interest earnings to the Municipal Participant Account. Since inception of the program, $300,000 had been collected representing twelve dockets, the proceedings for nine dockets have concluded, and seven have funds remaining, totaling $175,000 which should have been returned to the applicants as required by Section 16-50bb of the General Statutes.

3. **The Second Injury Fund should submit negotiated compensation agreements to the Workers' Compensation Commissioner for approval, ensure that self-insured employer assessment rates are applied without error and contest non-qualifying COLA reimbursement requests.**

   Comments:

   A claims analyst with the Fund reached an agreement with an injured worker's representative in regard to compensation payable; however, the payment does not appear accurate and the agreement was not submitted in writing to the Workers' Compensation

Commissioner for approval. During our review, we discovered that one self-insured employer was charged the higher assessment rate that applied to the previous year for the fiscal year ended June 30, 2009. This was not noticed until we brought it to the Fund's attention.

The Fund paid one insurance company a COLA reimbursement that was a negotiated amount. Our review of the supporting documentation for this negotiated payment indicated that a portion of the negotiated settlement included restitution for dates of service that were outside the eligibility period for reimbursement. The insurance company's actual COLA expense for this expired period was $26,400.

4. The State Treasury should administer its responsibility for the alternative assets with more diligence and care, improve the monitoring of advisors and its financial reporting, and be sure the guidelines are effectively applied.

Comments:

The alternative asset classes were not always administered to a level of prudent care during the due diligence, execution, monitoring and reporting stages to ensure accurate financial reporting.

5. The Treasurer's Pension Fund Management Division should appoint a local tax filing agent to expedite the repatriation of capital gains from foreign countries.

Comments:

The Pension Funds Management Division authorized an investment manager to invest in foreign stocks from the country of Taiwan without appointing a local tax filing agent. As a result, the manager made significant investments in Taiwan stocks, many of which have increased in value, but is unable to sell the stocks and realize any of the gains due to the inability to repatriate the income and capital gains.

INDEPENDENT AUDITORS' CERTIFICATION

Financial Statements:

We have audited the accompanying statement of net assets of the Combined Investment Funds, as of June 30, 2009, and the related statements of changes in net assets for the fiscal years ended June 30, 2009 and 2008. We have audited the accompanying statement of net assets of the Short-Term Investment Fund, including the list of investments as of June 30, 2009, and the related statements of changes in net assets for the fiscal years ended June 30, 2009 and 2008. We have audited the accompanying statement of net assets of the Short-Term Plus Investment Fund, including the list of investments as of June 30, 2009, and the related statement of changes in net assets for the fiscal year ended June 30, 2009. We have audited the statements of condition of the other Non-Civil List Trust Funds as of June 30, 2009, together with the related statements of revenue and expenditures, and statements of changes in fund balance and the statements of cash flows for the other Non-Civil List Trust Funds, for the fiscal year ended June 30, 2009. We have also audited the statement of net assets of the Second Injury Fund, together with the related statements of revenues, expenses and changes in fund net assets and the statements of cash flows for the Second Injury Fund, for the fiscal years ended June 30, 2009 and 2008. We have also examined the schedules of Civil List Funds investments, as of June 30, 2009, the Civil List Funds cash receipts and disbursements for the fiscal year ended June 30, 2009, and debt outstanding, as of June 30, 2009, and changes in debt outstanding during the fiscal year ended June 30, 2009. These financial statements and schedules are the responsibility of the management of the State Treasury. Our responsibility is to express an opinion on the financial statements and schedules based on our audit.

We did not audit the accompanying financial statements of the Tax Exempt Proceeds Fund, Inc. or the Connecticut Higher Education Trust. These financial statements were audited by other auditors whose reports thereon have been included with the accompanying financial statements. We did not audit the accompanying Schedules of Rates of Return for the Short-Term Investment Fund, which were examined by other auditors whose reports thereon have been included with the accompanying financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of June 30, 2009, by correspondence with the custodians. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in the notes to the financial schedules, the State Treasury has prepared the schedules of Civil List Funds investments, as of June 30, 2009, the Civil List Funds cash receipts and disbursements for the fiscal year ended June 30, 2009 and debt outstanding, as of June 30, 2009, and changes in debt outstanding during the fiscal year ended June 30, 2009, using accounting practices prescribed by the State Comptroller which practices differ from accounting principles generally accepted in the United States of America. The effects on the financial schedules of the variances between these regulatory accounting practices and accounting principles generally accepted in the United States of America although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the schedules referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the cash and investments of the Civil List Funds as of June 30, 2009, the Civil List Funds cash receipts and disbursements for the fiscal year ended June 30, 2009, the balance of bonds outstanding as of June 30, 2009, and bonds issued, retired and refunded, and bond interest payments made during the year ended on that date.

In our opinion, the schedules referred to above present fairly, in all material respects the cash and investments of the Civil List Funds as of June 30, 2009, the Civil List Funds cash receipts and disbursements for the fiscal year ended June 30, 2009, the balance of bonds outstanding as of June 30, 2009, and bonds issued, retired and refunded, and bond interest payments made during the year ended on that date, all in accordance with the modified cash basis of accounting, a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Combined Investment Funds, the Short-Term Investment Fund, the Short-Term Plus Investment Fund, the Second Injury Fund and other Non-Civil List Trust Funds as of June 30, 2009, and the results of their operations and changes in net assets for the year then ended, and the changes in fund balance for the other Non-Civil List Trust Funds and cash flows for the Second Injury Fund and the other Non-Civil List Trust Funds for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As explained in Note 1B to the financial statements of the Combined Investment Funds, the State Treasurer's policy is to present investments at fair value. The fair value of most of the assets of the Real Estate Fund, the Commercial Mortgage Fund and the Private Investment Fund are estimated by investment advisors in the absence of readily ascertainable market values, and reviewed and adjusted, when appropriate, by the State Treasurer. The fair value of most of the assets of the Real Estate Fund and the Private Investment Fund are presented at the cash adjusted fair values, which utilize the investment advisors' March 31, 2009, quarter ending estimated values adjusted for cash flows of the Funds during the subsequent quarter that affect the value at the Funds' level. Adjustments are made for underlying investments that experienced significant changes in value during the quarter, if deemed appropriate. We have reviewed the investment advisors' values, the relevant cash flows and the procedures used by the State Treasurer in reviewing the estimated values and have read underlying documentation and, in the circumstances, we believe the procedures to be reasonable and the documentation appropriate. However, because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the investments existed, and the differences could be material.

Compliance:

Compliance with the requirements of laws, regulations, contracts and grants applicable to the

State Treasury is the responsibility of the State Treasury's management.

As part of obtaining reasonable assurance about whether the Agency complied with laws, regulations, contracts, and grants, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on whether the financial statements referred to above are free of material misstatements, we performed tests of its compliance with certain provisions of laws, regulations and contracts. However, providing an opinion on compliance with these provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests did not disclose any instances of noncompliance that are required to be reported herein under *Government Auditing Standards*. However, we noted certain matters which we reported to Agency management in the accompanying "Condition of Records" and "Recommendations" sections of this report.

Internal Control over Financial Operations, Safeguarding of Assets and Compliance:

In planning and performing our audit, we considered the Office of the State Treasurer's internal control over its financial operations, safeguarding of assets, and compliance with requirements as a basis for designing our auditing procedures for the purpose of evaluating the Agency's financial operations, safeguarding of assets, and compliance with certain provisions of laws, regulations, contracts and grant agreements, but not for the purpose of providing assurance on the effectiveness of the Agency's internal control over those control objectives.

Our consideration of internal control over financial operations, safeguarding of assets, and compliance requirements was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial operations, safeguarding of assets and compliance with requirements that might b significant deficiencies or material weaknesses. However as discussed below, we identified certain deficiencies in internal control over financial operations, safeguarding of assets, and compliance with requirements that we consider to be significant deficiencies.

A *control deficie*ncy exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions , to prevent or detect on a timely basis unauthorized, illegal, or irregular transactions or the breakdown in the safekeeping of any asset or resource. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the Agency's ability to properly initiate, authorize, record, process, or report financial data reliably consistent with management's direction, safeguard assets, and/or comply with certain provisions of laws, regulations, contracts, and grant agreements such that there is more than a remote likelihood that a financial misstatement, unsafe treatment of assets, or noncompliance with laws, regulations, contracts and grant agreements that is more than inconsequential will not be prevented or detected by the Agency's internal control. We consider the following deficiencies described in the accompanying "Condition of Records" and "Recommendations" sections of this report to be significant deficiencies in internal control over financial operations, safeguarding of assets and compliance with requirements: the need to improve the cash reconciliation process and the administration and monitoring of alternative asset investments.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with certain provisions of laws, regulations, contracts, and grant agreements or the requirements to safeguard assets that would be material in relation to the Agency's financial operations, noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions and material financial misstatements by the Agency being audited will not be prevented or detected by the Agency's internal control.

Our consideration of the internal control over the Agency's financial operations, safeguarding of assets, and compliance with requirements was for the limited purpose described in the first paragraph of this section and would not necessarily disclose all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above are material weaknesses.

We also noted certain matters which we reported to Agency management in the accompanying "Condition of Records" and "Recommendations" sections of this report.

The State Treasury's responses to the findings identified in our audit are described in the accompanying "Condition of Records" section of this report. We did not audit the State Treasury's response and, accordingly, we express no opinion on it.

This report is intended for the information and use of Agency management, the Governor, the State Comptroller, the Appropriations Committee of the General Assembly and the Legislative Committee on Program Review and Investigations. However, this report is a matter of public record and its distribution is not limited.

CONCLUSION

In conclusion, we wish to express our appreciation for the cooperation and courtesies extended to our representatives by the personnel of the State Treasurer's Office during the course of our examination.

Thomas W. Willametz
Administrative Auditor

Approved:

Kevin P. Johnston	Robert G. Jaekle
Auditor of Public Accounts	Auditor of Public Accounts